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Supreme Court, U.S.
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October Term, 1996

AMERICAN BANKERS MORTGAGE CORPORATION,

Petitioner,

against

FEDERAL HOME LOAN MORTGAGE CORPORATION d/b/a "FREDDIE MAC",

Respondent.

THE MORTGAGE NETWORK, INC., MORTGAGE NETWORK SERVICING PARTNERS, MORTGAGE NETWORK SERVICING PARTNERS II, and ROBERT LAMB,

Petitioners,

against

FEDERAL HOME LOAN MORTGAGE CORPORATION d/b/a "FREDDIE MAC",

Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

PETITION FOR WRIT OF CERTIORARI

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QUESTION PRESENTED.

Whether the Courts below erred in concluding that Respondent Federal Home Loan Mortgage Corporation was not a Federal entity for Fifth Amendment purposes (deprivation of property without due process of law) upon the ground that the requisite control by the Federal Government could only be demonstrated by a showing that the President of the United States appointes a majority of the Board of Directors, thereby unnecessarily narrowing the holding of this Court in Lebron v. National Railroad Passenger Corporation, __ U.S.__, 115 S.Ct. 961 (1995).

Petitioners contend that this question should be answered in the affirmative.

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AMERICAN BANKERS MORTGAGE CORPORATION,

Petitioner,

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FEDERAL HOME LOAN MORTGAGE CORPORATION d/b/a "FREDDIE MAC"

Respondent

THE MORTGAGE NETWORK, INC., MORTGAGE NETWORK SERVICING PARTNERS, MORTGAGE NETWORK SERVICING PARTNERS II, and ROBERT LAMB,

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Respondent.

On Writ of Certiorari to the
United States Court of Appeals
For the Ninth Circuit

----------X

PETITION FOR A WRIT OF CERTIORARI

Petitioners, AMERICAN BANKERS MORTGAGE CORPORATION (hereinafter "Petitioner ABM") and THE MORTGAGE NETWORK, INC., MORTGAGE NETWORK SERVICING PARTNERS, MORTGAGE NETWORK SERVICING PARTNERS II, and ROBERT LAMB, (hereinafter "Petitioners TMNI") respectfully petition this Court to issue a writ of certiorari to review two Orders of the United States Court of Appeals for the Ninth Circuit, both dated February 12, 1996, which affirmed two orders of the United States District Court, Central District of California, (Hon. WILLIAM J. REA, U.S.D.J., dated May 12, 1993, in the case of AMERICAN BANKERS MORTGAGE CORPORATION and Hon. Linda H. McLaughlin, U.S.D.J., dated May 10, 1993) which dismissed the claims of Petitioners in response to motions for partial Summary Judgment brought by Respondent FEDERAL HOME LOAN MORTGAGE CORPORATION d/b/a "FREDDIE MAC".

Thereafter, all remaining Claims for Relief contained in Petitioners' Complaints were dismissed by the District Court. Petitioners seek certiorari solely with respect to the denial of their Fifth Amendment Claims (the Third Claim for Relief in both Complaints). Accordingly, Countrywide Credit Industries, Inc. and The BISYS Group, Inc., defendants in the original actions, are not parties to the present litigation, because the issues raised herein do not affect any of their rights or interests.

Appeals to the United States Court of Appeals for the Ninth Circuit followed. In their appeals, Petitioners, both Mortgage Banking Firms which were previously designated by Respondent Freddie Mac as "approved seller/servicers" contended that, with due respect to the District Court below, the dismissal of their claims was erroneous, and should have been reversed, because Respondent Freddie Mac is a Federal entity for Fifth Amendment purposes, as defined by this Court in its opinion in Lebron v. National Railroad Passenger Corporation, __ U.S.__, 115 S.Ct. 961 (1995).

In its Opinion of February 12, 1996, in the ABM case, [75 F.3d 1401 (9th Cir. 1996)] the Court of Appeals for the Ninth Circuit held:

The government, however, does not "control[ ] the operation of [Freddie Mac] through its appointees", Lebron, __ U.S. at __, 115 S.Ct. at 974. Freddie Mac's board of directors consists of 18 persons, of whom 13 are elected annually by the voting common shareholders. [9a] 12 U.S.C. § 1452(a)(2)-(A). Freddie Mac has apparently issued nearly 60 million common shares of stock, and its shares are publicly traded on the New York Stock Exchange. Amtrak, by contrast, had only four private shareholders at the time Lebron was decided. __ U.S. at __, 115 S.Ct. at 968. Freddie Mac's five remaining directors are appointed annually by the President, independently of the Senate. Thus, the U.S. government is entitled to appoint fewer than one-third of Freddie Mac's directors. Although the President must choose at least 1 director from each of four categories (the homebuilding industry, the mortgage lending industry, the real estate industry, and the consumer or low- income-housing communities), 12 U.S.C. § 1452(a)(2)(A), these provisions appear to be irrelevant to the issue of government control under Lebron, since the Court there viewed analogous requirements for presidential appointments to Amtrak's board as only "a restriction imposed by one of the political branches upon the other". Lebron, __ U.S. at __, 115 S.Ct. at 973.

On the other hand, the law governing Amtrak effectively provided at the time of Lebron for complete government control of that corporation's board, which consists of nine members: the Secretary of Transportation (ex officio); three directors chosen for four-year terms by the President with the advice and consent of the Senate; two directors appointed for two-year terms by the President with no Senate involvement; two directors elected for one-year terms by the holders of preferred stock, all of which was owned by the United States at the time of the decision in Lebron, __ U.S. at __, 115 S.Ct. at 968; and Amtrak's president, who is appointed by the Board

itself and serves at its pleasure. 49 U.S.C. § 24302. [FN4] The Lebron Court noted that "Amtrak's four private shareholders have not been entitled to vote in selecting the board of directors since 1981". __ U.S. at __, 115 S.Ct. at 968. Given that "six of the corporation's eight externally named directors ... are appointed directly by the President of the United States-- four of them ... with the advice and consent of the Senate", id. at 973, the Court concluded that Amtrak was a government-controlled corporation.

The current governance structure of Freddie Mac affords the government far less control over that corporation's operations than it had over Amtrak's operations in Lebron. Freddie Mac is far more analogous to the Communications Satellite Corporation (Comsat); only 3 of Comsat's 15 directors are appointed by the President. 47 U.S.C. § 733(a). The Lebron Court found Comsat to be "genuinely private". Id. (emphasis in original). Thus, the second element of the Lebron test for determining whether a federally chartered corporation is a federal entity, the government's control over the corporation, is missing in this case.

A copy of the Opinion of the Ninth Circuit dated February 12, 1996, is set forth as Appendix A.

JOINT PETITION

This is a joint petition for writ of certiorari pursuant to Rule 12.2 of this Court, to review two decisions of the Court of Appeals for the Ninth Circuit, involving identical questions.

OPINIONS BELOW

The Opinions and Orders of the District Court below, Hon. WILLIAM J. REA, U.S.D.J., dated May 12, 1993, in the case of AMERICAN BANKERS MORTGAGE CORPORATION and Hon.

Linda H. McLaughlin, U.S.D.J., dated May 10, 1993 in the case of THE MORTGAGE NETWORK, INC., which granted partial summary judgment, dismissing the Fifth Amendment claims of Petitioners, are set forth as Appendix B.

JURISDICTION

As stated above, the Orders of the Court of Appeals affirming the Opinions and Orders of the District Court, which granted partial summary judgment, dismissing the claims of Petitioners, were entered on February 12, 1996. According to Rule 13.1 of the United States Supreme Court Rules, this Petition for a Writ of Certiorari, having been filed within 90 days of February 12, 1996, is timely. Further, this Court's jurisdiction to review this case rests upon 28 U.S.C. §1254(1).

STATUTORY PROVISIONS INVOLVED

Fifth Amendment to the Constitution of the United States

> No person shall be held to answer for a capital, or otherwise infamous crime, unless on a presentment or indictment of a Grand Jury, except in cases arising in the land or naval forces, or in the Militia, when in actual service in time of War or public danger; nor shall any person be subject for the same offence to be twice put in jeopardy of life or limb; nor shall be compelled in any criminal case to be a witness against himself, nor be deprived of life, liberty, or property, without due process of law; nor shall private property be taken for public use, without just compensation.

STATEMENT OF CASE: ABM

On or about October 31, 1983, Petitioner ABM became an approved Freddie Mac Seller/Servicer. Approval as a Freddie Mac Seller/Servicer gave Petitioner the right to sell home mortgage loans

to Freddie Mac and to perform "servicing" on loans owned by Freddie Mac. The servicing function could validly apply both to loans originated by the Petitioner and sold to Freddie Mac and to loans originated by other mortgage brokers. There is a market among mortgage brokers by which servicing rights are freely bought and sold.

As a result of its regular fiscal year end audit for the twelve months ending on October 31, 1991, ABM became aware that certain apparent technical discrepancies may have existed between:

(a) the actual delinquencies on loans serviced by ABM and recorded within ABM's records, which were subject to audit at any time by Respondent Freddie Mac, and

(b) the delinquencies which were reported by ABM to Respondent Freddie Mac.

In an effort to resolve these apparent technical discrepancies, ABM undertook an internal investigation to determine their cause. It was ascertained by ABM that the apparent discrepancies were caused by imprecision in the reporting requirements promulgated by Respondent Freddie Mac, specifically with respect to whether 30-day delinquencies had to be reported. Several employees of ABM contacted various employees of Respondent Freddie Mac and received conflicting instructions regarding the reporting of 30-day delinquencies.

In an effort to fully comply with the imprecise reporting requirements of Respondent Freddie Mac, a decision was made by the corporate officers of ABM to contact Respondent Freddie Mac and fully report all of the facts concerning the situation to an official of Respondent Freddie Mac. This was done via telephone on January 24, 1992 and followed-up by letter dated January 31, 1992.

In response to ABM's attempt to make full and accurate reports to Respondent Freddie Mac, Respondent suspended ABM's Seller/Servicer contract, effective February 11, 1992, pending a review by Freddie Mac personnel of ABM's servicing and operations departments.

Such a review was conducted during the weeks of February 10 and February 17, 1992, by two senior officials of Respondent Freddie Mac,

Dean McGee and Dennis Maxson. The conclusion reached by these officials was that since Respondent Freddie Mac had not been damaged in any way, they would not recommend the termination of ABM. Agreement was reached between said officials and ABM regarding the reporting of delinquencies. Certain other suggestions were made by said officials for improving the accuracy of the reporting made by ABM to Respondent Freddie Mac, to which suggestions ABM readily agreed.

On February 24, 1992, without any further warning, Harlan Kipp of Respondent Freddie Mac and Elaine Cowan of Countrywide entered the main office of ABM and announced "We are here to take your servicing." They proceeded to seize more than 3,000 loan files, having an aggregate value of approximately $400 million in loans which were being serviced for Respondent Freddie Mac by ABM, having a market value of approximately $8 million. In addition, they seized approximately $20 million in loans being serviced by ABM for Fannie Mae and certain other mortgage holders. Petitioner ABM did not consent to the seizure of any of the above property, which was taken by Respondent over the Petitioner's protests.

In addition to seizing servicing files, Respondent Freddie Mac seized ABM's trust account, at First Interstate Bank, containing more than $4 million. In addition to containing funds which were ultimately payable to Respondent Freddie Mac, this account contained approximately $500,000.00 in funds belonging to entities other than Respondent Freddie Mac, to wit, approximately $380,000.00 belonging to ABM and approximately $120,000.00 due Fannie Mae from ABM.

On February 26, 1992, Respondent Freddie Mac issued a letter to ABM terminating the latest of a series of Master Commitment Contracts which was dated November 22, 1991, designated #M91112290 (Mandatory) Seller/Servicer #400002.

In response to questions put to Respondent Freddie Mac by officers of ABM, Respondent Freddie Mac refused to compensate ABM in any way for the servicing rights which were seized or to allow ABM to sell the servicing rights on the open market to a Freddie Mac approved

seller/servicer. To date, Petitioner ABM has received no compensation whatever from any source for the seized portfolio of servicing rights.

An administrative "appeal," dated March 30, 1992, was filed by ABM in the nature of an internal review within Freddie Mac. Said appeal was denied by letter, dated April 30, 1992, over the signature of Gerald Langbauer. Petitioner's Complaint alleged, upon information and belief, that Gerald Langbauer participated in the initial decision made by Respondent Freddie Mac to terminate ABM.

After it was suspended by Respondent Freddie Mac, but before it was terminated, ABM contacted Countrywide to offer to sell its servicing portfolio to Countrywide at the going market rate.

A broker for Countrywide, one James Bush requested that Petitioner ABM deliver a trial balance of its Freddie Mac servicing portfolio to an employee of Countrywide, one David Sambol. Petitioner arranged to provide the requested information to Countrywide, with the understanding that Countrywide required this information in order to evaluate the market value of ABM's servicing portfolio in order to determine the amount it would offer to purchase same.

Countrywide therefore had ample opportunity to evaluate the contents and value of Petitioner's servicing portfolio prior to February 24, 1992.

On February 24, 1992 an employee of Countrywide, Elaine Cowan, was physically present in the offices of Petitioner and took part in the seizure of the files constituting Petitioner's servicing portfolio by Respondent Freddie Mac.

After the seizure of said files, Respondent Freddie Mac instructed Petitioner to turn over all checks made payable to Petitioner on account of the mortgage loans represented by Petitioner's servicing portfolio to Countrywide. It is estimated that the aggregate value of said checks amounted to between $5 million and $8 million. The checks were deposited into bank accounts maintained by Countrywide.

In this manner, the servicing portfolio belonging to Petitioner became the property of Countrywide. Significantly, Countrywide received Petitioner's servicing portfolio while in the midst of supposed

negotiations and evaluations which it led Petitioner to believe would result in the payment of a substantial amount of money, believed to be approximately $8 million, representing the market value of said portfolio. As events unfolded, Countrywide received Petitioner's servicing portfolio without paying Petitioner any compensation.

STATEMENT OF CASE: TMNI

On or about April 21, 1987, Petitioner TMNI became an approved Freddie Mac Seller/Servicer. Approval had the same effects as described above in the Statement of Case: ABM.

During May, 1992, TMNI received notice that Freddie Mac would conduct an audit of its operations from June 15, 1992 through June 17, 1992. During the audit, Freddie Mac auditors asked routine questions as to the manner in which TMNI conducted business, generally related to loan volumes, staffing, secondary marketing and servicing related issues. The auditors seemed genuinely interested in TMNI's capital position and future plans, including the limited partnership arrangements by which Petitioners Mortgage Network Servicing Partners, and Mortgage Network Servicing Partners II were set up, and a proposal to make a public offering.

The audit was interrupted when a second group of Freddie Mac auditors arrived. This group appeared interested in certain irregularities which related to certain sub-servicing functions performed for Petitioner TMNI by Tridatatron. All but one of the auditors shortly left Petitioner TMNI's offices and went to the offices of Tridatatron. The one auditor who remained had a previously prepared list of loans he specifically wished to examine. Petitioners were advised on June 16, 1992 that difficulties had been discovered in certain loans examined by this auditor involved self-employed Vietnamese-American borrowers.

At the exit interview of the Freddie Mac audit on June 17, 1992, Petitioners were advised by the auditors that an area of concern was their discovery of certain of the loans involving the Vietnamese-

American community, which the auditors concluded were not auditable, and therefore not of investment quality.

The attitude of animosity toward the Vietnamese-American community displayed by the auditors employed by Respondent Freddie Mac at the June 15-17, 1992 audit put Petitioner TMNI in a position in which, in order to continue to do business with Respondent Freddie Mac, which Petitioner TMNI regarded as a federal entity, Petitioner TMNI could possibly be held to have violated 42 U.S.C. §3605, prohibiting discrimination in residential real estate-related transactions.

On June 19, 1992, Petitioner Lamb spoke with a Freddie Mac official, Mr. Gerald Langbauer. During the telephone conversation, Mr. Langbauer stated that Freddie Mac was disturbed about the problem loan segment involving the Vietnamese-Americans and requested that TMNI consent to a second audit. Petitioner Lamb readily consented stating that TMNI had nothing to hide. Mr. Langbauer stated that there might be a requirement that TMNI repurchase certain of the problem loans. He further stated that if TMNI cooperated fully, some sort of indemnification plan could be arranged.

On Monday, June 22, 1992, the Freddie Mac auditor arrived and examined the problem loan segment involving the Vietnamese-American community. At the end of the day the auditor advised Mr. Griffin, an employee of Petitioner TMNI, that "his suspicions were confirmed." By utilizing a specially designed software program available only to Freddie Mac or other Federal Agency, the auditor supposedly ascertained that a number of loans originated by the TMNI branch at San Jose utilized a false tax-preparer's social security number. As a direct result of the allegations made by the Freddie Mac auditor, Petitioner Lamb contemplated the termination of the San Jose branch of Petitioner TMNI.

The allegation that the San Jose branch utilized a false tax preparer's social security number for certain of its loans was information which TMNI could not have obtained by any means available to mortgage bankers in the private sector, nor was it made a requirement of the

Freddie Mac Sellers' and Servicers' Guide. In answer to a question raised on behalf of Petitioner TMNI as to whether it was possible that the tax returns were valid even though the tax preparer's social security number may have been false the Freddie Mac auditor stated that he had cross-checked the information contained in TMNI's records with records maintained by the Internal Revenue Service, by means of a direct telephone connection, via modem, to his portable computer. Such cross-checking with Internal Revenue records cannot be accomplished by mortgage bankers or any other business entities operating in the private sector.

On Tuesday, June 23, 1992, the Freddie Mac auditor continued his investigation and advised Petitioner TMNI that his discoveries with respect to the San Jose branch of TMNI were ascertained to be a pattern which allegedly existed in all Vietnamese-American branches. Accordingly, Petitioner Lamb determined to terminate TMNI's San Jose branch immediately, and to consider taking action as to the other branches at issue at a later date.

Thereafter, Mr. Langbauer advised Petitioner TMNI that Freddie Mac had received a letter implying that a certain TMNI Regional Vice President, Than Q. Tran, a Vietnamese-American, took part in the originating of fraudulent loans. Based on this allegation, Petitioner TMNI determined that all remaining branches in Vietnamese-American neighborhoods would be terminated immediately, and that the Freddie Mac auditor who was present would be so advised.

Petitioner TMNI then inquired of the Freddie Mac auditor concerning the status of branches of TMNI which serviced other communities. The auditor stated that there were no irregularities to mention in those branches.

After the auditor left Petitioners' offices on June 24, 1992, Petitioners heard nothing from Respondent Freddie Mac until, on July 2, 1992, personnel in the TMNI office were advised that Petitioner TMNI was being terminated as an approved Freddie Mac seller/servicer. Simultaneously, personnel from Freddie Mac arrived at the TMNI office and removed all of TMNI's files containing Petitioners' mortgage

servicing portfolios, consisting of approximately $330 million worth of home mortgages in the case of Petitioner TMNI, $435 million worth of home mortgages in the case of Petitioner Mortgage Network Servicing Partners, and $235 million worth of home mortgages in the case of Petitioner Mortgage Network Servicing Partners II, for a total of approximately $1 billion worth of home mortgages. This was done without Court order or other judicial sanction, and in violation of the due process clause of the Fifth Amendment to the United States Constitution.

Accompanying the Freddie Mac personnel who arrived at the TMNI office on July 2, 1992 to remove all of TMNI's files was an employee of Tridatatron, one Rhonda Headington, who assisted in the seizure of the files of TMNI.

As a result of the termination of Petitioner TMNI as an approved Freddie Mac seller/servicer, the entire servicing portfolios of Petitioners TMNI, Mortgage Network Servicing Partners, and Mortgage Network Servicing Partners II were given to Tridatatron by Respondent Freddie Mac to service, at least for a period of several months, until Freddie Mac could make other arrangements. During this period of time, Tridatatron increased its own income by a considerable amount, in that it was now paid the full servicing fee customarily paid by Respondent Freddie Mac, rather than the much smaller amount to which Tridatatron was entitled under the terms of its sub-servicing agreement with TMNI. The difference in income to Tridatatron, directly or in behalf of Freddie Mac, amounted to approximately $200,000 per month. Upon information and belief, this temporary arrangement lasted for approximately eight months, and therefore increased the gross income of Tridatatron by approximately $1.6 million.

In addition, Tridatatron was in possession of the said servicing portfolios, not only during the period when it was a sub-servicer for Petitioner TMNI, but also for the period after the termination of Petitioner TMNI as an approved seller/servicer. This gave Tridatatron a significant advantage over other financial institutions to evaluate the

components of said servicing portfolios, so that, in the event Respondent Freddie Mac chose to offer said portfolios for sale on the open market, Tridatatron and/or BISYS, or any other subsidiary or affiliate of BISYS, put themselves in a position of superior knowledge allowing them to successfully bid for the most lucrative portions of said portfolios, as against outside financial institutions who might choose to bid for said portfolios.

The United States District Court, Central District of California, (Hon. WILLIAM J. REA, U.S.D.J., dated May 12, 1993, in the case of AMERICAN BANKERS MORTGAGE CORPORATION and Hon. Linda H. McLaughlin, U.S.D.J., dated May 10, 1993) dismissed the Fifth Amendment claims of Petitioners in response to motions for partial Summary Judgment brought by Respondent FEDERAL HOME LOAN MORTGAGE CORPORATION d/b/a "FREDDIE MAC".

Thereafter, all remaining Claims for Relief contained in Petitioners' Complaints were dismissed by the District Court.

Appeals to the United States Court of Appeals for the Ninth Circuit followed. In their appeals, Petitioners contended that the dismissal of their claims was erroneous, and should have been reversed, because Respondent Freddie Mac is a Federal entity for Fifth Amendment purposes, as defined by this Court in its opinion in Lebron v. National Railroad Passenger Corporation, __ U.S.__, 115 S.Ct. 961 (1995). On February 12, 1996, the United States Court of Appeals for the Ninth Circuit affirmed said Orders.

REASONS FOR GRANTING THE PETITION

I. The Courts below erred in dismissing Petitioners' action, in that they concluded that Respondent Federal Home Loan Mortgage Corporation was not a Federal entity for Fifth Amendment purposes, upon the ground that the requisite control by the Federal Government can only be demonstrated by a showing that the President of the United States appoints a majority of the Board of Directors, and cannot be demonstrated by a showing of the regulation of Respondent Federal Home Loan Mortgage Corporation by Federal Law, as urged by Petitioners in the Courts below, thereby unnecessarily narrowing the holding of this Court in Lebron v. National Railroad Passenger Corporation, __ U.S.__, 115 S.Ct. 961 (1995).

In its published opinion in the ABM case [75 F.3d 1401 (9th Cir. 1996)] the Court of Appeals for the Ninth Circuit held:

> Since Freddie Mac is a corporation chartered by Congress, the two relevant criteria for judging Freddie Mac's status as a federal entity for Fifth Amendment purposes are the extent to which its objectives are governmental and the extent to which the government directs and controls the corporation's pursuit of those objectives.
>
> * * *
>
> Thus, Freddie Mac's purposes are "federal governmental objectives" for the purpose of analyzing whether or not Freddie Mac is a government entity.
>
> * * *
>
> The government, however, does not "control[ ] the operation of [Freddie Mac] through its appointees", Lebron, __ U.S. at__, 115 S.Ct. at 974.
>
> * * *
>
> Thus, the U.S. government is entitled to appoint fewer than one-third of Freddie Mac's directors.

* * *

While Freddie Mac is chartered to pursue federal governmental objectives, the level of government control over the corporation is so much lower than that exercised over Amtrak we conclude that, upon an application of Lebron principles, that Freddie Mac is not a government agency subject to the Fifth Amendment's Due Process Clause.

* * *

Appellant suggests a nexus between the government and Freddie Mac's termination by reciting a litany of U.S. government regulations applicable to Freddie Mac. [14a-15a] However, "[e]ven extensive regulation by the government does not transform the actions of the regulated entity into those of the government". San Francisco Arts & Athletics, 483 U.S. at 544 (citing Jackson v. Metro. Edison Co., 419 U.S. 345 (1974)). The Jackson Court explained that even "extensive and detailed [regulation], as in the case of most public utilities" does not turn private action into state action. 419 U.S. at 350. Instead, "the inquiry must be whether there is a sufficiently close nexus between the State and the challenged action of the regulated entity so that the action of the latter may be fairly treated as that of the State itself". Id. at 351. The regulations regarding Freddie Mac appear substantially less "extensive and detailed" than those typically imposed on public utilities. More importantly, ABM has failed to allege any nexus between those regulations and the challenged actions by Freddie Mac, i.e., the termination of ABM as a seller/servicer. Cf. Rendell-Baker v. Kohn, 457 U.S. 830, 841 (1982) (petitioners challenging discharge by private school had not shown decisions were compelled or even influenced by state regulation; in contrast to extensive regulation of school generally, regulators showed little interest in personnel matters). Although appellant points to the requirement of 12 U.S.C. § 1456(f)(2)(J) that Freddie Mac

> report to Congress and HUD on, among other matters, the race and gender of approved seller/servicers, they offer no suggestion of how this requirement might even be related to the particular termination decisions challenged here, let alone how this requirement presents a sufficiently close nexus for state action purposes. Cf. Liberty Mortgage, 822 F.Supp. at 959 ("[N]o federal agency exercises any oversight or regulatory control over the day-to-day decision making of Freddie Mac. Thus, there is not a sufficiently close nexus between Freddie Mac's decision to terminate Liberty and the federal government to treat the termination as government action.").

Petitioners submit that the above holding represents an unnecessary narrowing of the opinion of this Court in Lebron v. National Railroad Passenger Corporation, __U.S.__, 115 S.Ct. 961 (1995), in which this Court held that the appointment by the President of a majority of the board of directors was but one means by which the Federal Government may be said to be in control of a quasi-governmental entity, for purposes of deciding whether that entity owes private parties who deal with it the rights to which they are Constitutionally entitled, such as their Fifth Amendment Rights. This Court held in Lebron, (115 S.Ct. 974):

> Amtrak is worlds apart from Conrail: the Government exerts its control not as a creditor but as a policymaker, and no provision exists that will automatically terminate control upon termination of a temporary financial interest.

While the strict holding in Lebron was based upon the fact that the Federal Government appoints a majority of the Board of Directors of Amtrak, the above language is indicative of the fact that the opinion of this Court in Lebron was that the significant factor in determining whether government control exists is not limited to situations in which a simple arithmetical calculation may be made that government control exists where the President appoints a majority of the board of directors, but may also be found where there is such extensive governmental regulation that it may be said that the government acts as a policy

maker, on a permanent rather than a temporary basis. Under such circumstances, as were presented to the Courts below, sufficient government control exists for a finding that a quasi-government entity owes private parties, who deal with the entity, their rights under the Constitution.

Petitioners submit that the control exercised by the Federal government over Respondent Freddie Mac is sufficiently of a policy making nature, and is permanent, for a finding that Freddie Mac owed Fifth Amendment Rights to the Petitioners herein. The following constitutes the bases for Petitioners' contention that the Federal government controls Freddie Mac as a policy maker.

Respondent Freddie Mac was established by Act of Congress, see 12 U.S.C. Chapter 11A. Significant language bearing on the question of whether or not Respondent Freddie Mac is a federal agency is contained at 12 U.S.C. § 1452(f), which states:

> Notwithstanding section 1349 of Title 28 or any other provision of law, (1) the Corporation shall be deemed to be an agency included in sections 1345 and 1442 of such Title 28;
> * * *

Sections 1345 and 1442 of Title 28 provide further information as to the nature of Respondent Freddie Mac. Section 1345 provides:

> Except as otherwise provided by Act of Congress, the district courts shall have original jurisdiction of all civil actions, suits or proceedings commenced by the United States, or by any agency or officer thereof expressly authorized to sue by Act of Congress.

Similarly, 28 U.S.C. § 1442 provides, in pertinent part:

> (a) A civil action or criminal prosecution commenced in a State court against any of the following persons may be removed by them to the district court of the United States for the district and division embracing the place wherein it is pending:

> (1) Any officer of the United States or any agency thereof...

It is therefore clear that the statute which created Respondent Freddie Mac defined it as an agency of the United States. The decisions of the Courts below relied heavily upon the opinion of this Court in San Francisco Arts & Athletics, Inc. v. United States Olympic Committee, 483 U.S. 522 (1987). The entity which the plaintiff sought to have declared governmental in San Francisco Arts was the United States Olympic Committee, which was established as a "private corporation" under 36 U.S.C. § 1101(46), San Francisco Arts, 483 U.S. at 542-543, along with 69 other federally-created private corporations, including such organizations as The American Legion, The Big Brothers-Big Sisters of America, The Daughters of the American Revolution, The Veterans of Foreign Wars, etc.

The fact that the statute establishing these entities refers to them as private corporations is in marked contrast to the statute establishing Freddie Mac, 12 U.S.C. § 1452(f), which states, in so many words that Freddie Mac "shall be deemed to be an agency" under 28 U.S.C. §§ 1345 and 1442.

Pursuant to 12 U.S.C. § 1456(f), Freddie Mac is required to submit a report to the Committee on Banking, Finance and Urban Affairs of the House of Representatives, the Committee on Banking, Housing and Urban Affairs of the Senate, and the Secretary of Housing and Urban Development. This report is particularly significant because Freddie Mac is required, *inter alia*, to:

> describe in the aggregate the seller and servicer network of the Corporation, including the volume of mortgages purchased from minority-owned, women-owned, and community-oriented lenders, and any efforts to facilitate relationships with such lenders. [12 U.S.C. §1456(f)(2)(J)]

The gravamen of this action is that Petitioners ABM and TMNI were wrongfully terminated as Freddie Mac approved seller/servicers. The above paragraph demonstrates that the government has a continuing interest and involvement in such seller/servicers. Consequently,

Petitioners submit that Respondent Freddie Mac should be held to the standards of the due process clause of the Fifth Amendment under the holding in San Francisco Arts.

In the case of Geneva Towers Tenants Org. v. Federated Mortgage Inv., 504 F.2d 483, 487 (9th Cir. 1974), the Ninth Circuit dealt with a private entity less closely related to the federal government than is Respondent Freddie Mac, and concluded:

> Private investors such as Geneva Apartments, Inc. and Kate Maremont Foundation, are engaged in a joint undertaking with the federal government to provide housing for low and moderate income families. Participation in the § 221(d)(3) program subject the investors to an elaborate and pervasive body of government regulations. The benefits are mutual. The investors are able to construct facilities aided by government financing, below-market interest rates and tax advantages. The government alleviates the housing crisis and insures compliance with its goal through a monitoring system that commences with construction of the housing and does not terminate until the mortgagors' obligations are satisfied.
>
> * * *
>
> We hold the fifth Amendment applicable to these § 221(d)(3) projects.

It is respectfully submitted that the description of the private investors taking part in the § 221(d)(3) programs in Geneva Towers is equally applicable to the Respondent Freddie Mac herein. In Geneva Towers, the private investors were engaged in a joint undertaking with the federal government to provide housing for low and moderate income families. The same is true of Freddie Mac.

In Geneva Towers, this Court observed that participation in the program subjects the investors to an elaborate and pervasive body of government regulations. Even after the adoption of FIRREA, which allegedly "privatized" Freddie Mac, Respondent continues to be subject to such regulations.

For example, 12 U.S.C. § 1452(a)(2)(A) provides that the Board of Directors of Freddie Mac shall consist of 18 persons, five of whom are appointed by the President, who must appoint at least one person from each of the following: the home building industry, the mortgage lending industry, the real estate industry, and "an organization that has represented consumer or community interests for not less than two years" or "who has demonstrated a career commitment to the provision of housing for low income households."

In addition, 12 U.S.C. § 1452(h)(1) provides that Freddie Mac shall submit a detailed annual report to the Committee on Banking, Finance and Urban Affairs of the House of Representatives and the Committee on Banking, Housing and Urban Affairs of the Senate, covering the following:

> (A) the comparability of the compensation policies of the Corporation with the compensation policies of other similar businesses,
>
> (B) in the aggregate, the percentage of total cash compensation and payments under employee benefit plans (which shall be defined in a manner consistent with the Corporation's proxy statement for the annual meeting of shareholders for the preceding year) earned by executive officers of the Corporation during the preceding year that was based on the Corporation's performance, and
>
> (C) the comparability of the Corporation's financial performance with the performance of other similar businesses. The report shall include a copy of the Corporation's proxy statement for the annual meeting of shareholders for the preceding year.

Another example of the "elaborate and pervasive body of government regulations" to which Freddie Mac is subject is found at 12 U.S.C. § 1452(h)(2), which provides that after October 28, 1992, Freddie Mac may not enter into any agreement to provide any money or thing of current or potential value in connection with the termination of employment of any of its executive officers unless such agreement

or contract is approved in advance by the Director of the Office of Federal Housing Enterprise Oversight of HUD.

Yet another example is found at 12 U.S.C. § 1454(a)(2), which provides for minute regulation of Freddie Mac by the government with regard to the most basic day-to-day operation of its business, the granting of home mortgages. The statute states:

> No conventional mortgage secured by a property comprising one- to four-family dwelling units shall be purchased under this section if the outstanding principal balance of the mortgage at the time of purchase exceeds 80 per centum of the value of the property securing the mortgage, unless (A) the seller retains a participation of not less than 10 per centum in the mortgage; (B) for such period and under such circumstances as the Corporation may require, the seller agrees to repurchase or replace the mortgage upon demand of the Corporation in the event that the mortgage is in default; or (C) that portion of the unpaid principal balance of the mortgage which is in excess of such 80 per centum is guaranteed or insured by a qualified insurer as determined by the Corporation. The Corporation shall not issue a commitment to purchase a conventional mortgage prior to the date the mortgage is originated, if such mortgage is eligible for purchase under the preceding sentence only by reason of compliance with the requirements of clause (A) of such sentence. The Corporation may purchase a conventional mortgage which was originated more than one year prior to the purchase date only if the seller is the Federal Deposit Insurance Corporation, the Resolution Trust Corporation, the National Credit Union Administration, or any other seller currently engaged in mortgage lending or investing activities. With respect to any transaction in which a seller contemporaneously sells mortgages originated more than one year old prior to the date of sale to the Corporation and receives in payment for such mortgages securities representing undivided

interests only in those mortgages, the Corporation shall not impose any fee or charge upon an eligible seller which is not a member of a Federal Home Loan Bank which differs from that imposed upon an eligible seller which is such a member. The Corporation shall establish limitations governing the maximum original principal obligation of conventional mortgages that are purchased by it; in any case in which the Corporation purchases a participation interest in such a mortgage, the limitation shall be calculated with respect to the total original principal obligation of the mortgage and not merely with respect to the interest purchased by the Corporation. Such limitations shall not exceed $93,750 for a mortgage secured by a single-family residence, $120,000 for a mortgage secured by a two-family residence, $145,000 for a mortgage secured by a three-family residence, and $180,000 for a mortgage secured by a four-family residence, except that such maximum limitations shall be adjusted effective January 1 of each year beginning with 1981. Each such adjustment shall be made by adding to each such amount (as it may have been previously adjusted) a percentage thereof equal to the percentage increase during the twelve-month period ending with the previous October in the national average one-family house price in the monthly survey of all major lenders conducted by the Federal Housing Finance Board. With respect to mortgages secured by property comprising five or more family dwelling units, such limitations shall not exceed 125 per centum of the dollar amounts set forth in section 207(c)(3) of the National Housing Act, [12 U.S.C.A. Sec. 1713(c)(3)], except that such limitations may be increased by the Corporation (taking into account construction costs) to not to exceed 240 per centum of such dollar amounts in any geographical area for which the Secretary of Housing and Urban Development determines under such section that cost levels require any increase in the dollar amount limitations

> under such section. The foregoing limitations may be increased by not to exceed 50 per centum with respect to properties located in Alaska, Guam, Hawaii, and the Virgin Islands.

The above limitations place the government, by legislative enactment, squarely in control of the operation of the business of Freddie Mac, as a policymaker, most notably where the actual revenue calculations are mandated by both amount and collateral, and are adjusted by specific increments year to year.

In addition, 12 U.S.C. § 1455(j)(1), provides that the Secretary of the Treasury must approve both the maturity and the rate of interest of any unsecured obligations issued by Freddie Mac. A similar provision with regard to debt obligations or trust certificates of beneficial interest, or both, requiring approval by the Secretary of the Treasury is found at 12 U.S.C. § 1455(k)(1).

In addition, 12 U.S.C. § 1456(b)(1) provides that the programs, activities, receipts, expenditures and financial transactions of Freddie Mac are to be audited by the Comptroller General of the United States, under rules and regulations prescribed by the Comptroller General. A report on each such audit must be made by the Comptroller General to the Congress.

Beyond the auditing of Freddie Mac by the Comptroller General, 12 U.S.C. § 1456(c) requires Freddie Mac to submit annual and quarterly reports of its financial condition and operations to the Director of the Office of Federal Housing Oversight of HUD.

In addition to the above reports, Freddie Mac is also required to submit a report to the Committee on Banking, Finance and Urban Affairs of the House of Representatives, the Committee on Banking, Housing and Urban Affairs of the Senate, and the Secretary of HUD, pursuant to 12 U.S.C. § 1456(f). This report is particularly significant because Freddie Mac is required, *inter alia*, to include in this report a breakdown of the number of families served by Freddie Mac by income class, race, and gender, and to assess the underwriting standards, business practices, repurchase requirements, pricing, fees

and procedures that affect the purchase of mortgages for low and moderate income families or that may yield disparate results based on the race of the borrower, including revisions thereto to promote affordable housing or fair lending.

In addition, this report must include specific information with respect to the race and gender of approved seller/servicers, see 12 U.S.C. § 1456(f)(2)(J). This requirement is particularly significant in that it demonstrates continuing governmental control and interest in the identity of Freddie Mac approved sellers and servicers, such as, *inter alia*, the Petitioner.

Another characteristic described by the Ninth Circuit in Geneva Towers is that the relationship between the private entity and the government creates mutual benefits, 504 F.2d at 488. Where this characteristic is found in conjunction with an elaborate and pervasive body of government regulations applicable to the private entity, the entity in question is held to the standards of the due process clause. This relationship is present with respect to Freddie Mac. The chief benefits to Freddie Mac are found at 12 U.S.C. § 1452(e), which provides that Freddie Mac is exempt from all taxation imposed by any territory, dependency, or possession of the United States or by any State, county, municipality, or locality, and at 12 U.S.C. § 1455(c), which grants the Secretary of the Treasury standing authority to purchase obligations of Freddie Mac up to a maximum aggregate amount of $2,250,000,000.

Freddie Mac clearly enjoys the financial support of the government in the form of both tax exemption and investment. The government, in turn, utilizes Freddie Mac to further the housing goals it considers socially desirable, specifically in making homes available to low and moderate income persons, minorities, and women. See 12 U.S.C. § 1456(f)(1), referring to the federally mandated housing goals established at 12 U.S.C. § 4561, et seq.

In addition, 12 U.S.C. § 1456(g) requires Freddie Mac to appoint an Affordable Housing Advisory Council, consisting of 15 individuals, including representatives of community-based and other non-profit and

for-profit organizations and State and local government agencies actively engaged in the promotion, development, or financing of housing for low and moderate income families.

Specific mandates are given to Freddie Mac by the Government to meet "special affordable housing goals", see 12 U.S.C. § 4563 (d)(2).

There is a further requirement, contained at 12 U.S.C. § 4562 (d)(1), that the purchases of low and moderate income mortgages by Freddie Mac, be 30% of the total number of mortgages purchased during the period specified.

In addition, the government mandates that mortgage money be made available in "central cities, rural areas, and other underserved areas." Freddie Mac is required by 12 U.S.C. § 4564(d) to purchase 30% of its mortgages within central cities.

In short, Freddie Mac is far from being a private entity, solely responsible to its shareholders and solely interested in making a profit. Freddie Mac is indisputably utilized by the government as an agency of social change, to meet housing goals, contained in 12 U.S.C. § 4561, et seq., which are considered desirable by the government. In sum, the Federal government exercises control, as a policymaker, through Federal Statutes, over virtually all of the policies which would normally be decided by a private corporation for itself. Freddie Mac is in fact subject to such pervasive governmental intervention and outright control as to entirely obviate any finding of that Freddie Mac is a private entity.

The Court is respectfully reminded of the test prescribed by the Ninth Circuit in Geneva Towers for determining whether there is sufficient government involvement to hold the Fifth Amendment applicable to a private entity. The private entity and the government in Geneva Towers were engaged in a joint undertaking to provide housing for low and moderate income families. As demonstrated above, Freddie Mac is engaged in a congressionally-mandated undertaking to provide housing for low and moderate income families and to provide housing in central cities.

In Geneva Towers, the Ninth Circuit noted that the governmental program subjected the private entity to "an elaborate and pervasive body of government regulations." Clearly, Freddie Mac is subject to an elaborate and pervasive body of government regulations.

In Geneva Towers, there were mutual benefits for both the private entity and the government. The private entity was aided by government financing and tax advantages. As has been demonstrated above, Freddie Mac is the beneficiary of similar benefits.

With respect to the benefits to the government, in Geneva Towers, the Ninth Circuit held that the government's benefits were the alleviation of the housing crisis and a body of regulations and reporting obligations to insure compliance with its goal. Freddie Mac is similarly charged with a governmental mandate to provide mortgage money to those segments of the population which the government has found to be undeserved, and requires numerous reports to assure that Freddie Mac is advancing that goal.

In sum, every characteristic which the Ninth Circuit found to be persuasive in Geneva Towers for the purpose of holding the Fifth Amendment applicable to private entities is also present in the case of Freddie Mac. The language used by this Court in Lebron, requiring a showing that the Government act as a "policymaker" on a permanent basis, is manifestly applicable to Freddie Mac.

Petitioners respectfully refer this Court to the decision of the Seventh Circuit in Del's Big Saver Foods, Inc. v. Carpenter Cook, Inc., 795 F.2d 1344 (7th Cir. 1986), in which the Court held that:

> A state cannot avoid its obligations under the due process clause by delegating to private persons the authority to deprive people of their property without due process of law.

See also, in this regard, Giannattasio v. Stamford Youth Hockey Association, Inc., 621 F.Supp. 825 (D.C. Conn. 1985):

> The "public function" doctrine holds that when private persons are engaged in the exercise of governmental functions their activities are subject to similar constitutional restrictions. In other words, the state cannot free itself from the limitations

> of the Constitution in the operation of its governmental functions merely be delegating certain functions to otherwise private individuals.

The circumstances detailed above mandate the conclusion that Freddie Mac is subject to "an elaborate and pervasive body of government regulations" and that its conduct of business is thoroughly "entwined with government policies." It is equally clear that the Federal Government is a "policymaker" on a permanent basis with respect to the daily operations of Freddie Mac. Accordingly, the due process provisions of the Fifth Amendment should be applied to Freddie Mac.

II. The Opinion of the Ninth Circuit, that the requisite control by the Federal Government can only be demonstrated by a showing that the President of the United States appoints a majority of the Board of Directors, and cannot be shown by the regulation of Respondent Federal Home Loan Mortgage Corporation by Federal Law, as urged by Petitioners in the Courts below, is in direct conflict with the opinion of the First Circuit in the case of T I Federal Credit Union v. Delbonis, 72 F.3d 921 (1st Cir. 1995), requiring a ruling by this Court to eliminate the present conflict between the First and Ninth Circuits.

In the case of T I Federal Credit Union v. Delbonis, 72 F.3d 921 (1st Cir. 1995), the First Circuit held that Federal Credit Unions are government entities, in spite of the fact that no members of their boards of directors are appointed by the Federal government, on the basis of the fact that they are extensively regulated by the Federal government, citing to this Court's opinion in Lebron. The First Circuit held in pertenant part (72 F.3d 934-937):

> The imprimatur Congress places on federal credit unions by way of tax exemption is not the only additional feature which

convinces us of federal credit unions' special status. Extensive government regulation further distinguishes federal credit unions from ordinary proprietary organizations. The NCUA administers programs and promulgates regulations for credit union chartering, membership, and governance in accordance with the Administrative Procedure Act, 5 U.S.C.A. Sec. 551 et seq. See 12 U.S.C. Sec. 1752a; see also 12 C.F.R. Secs. 701.1, 708, 709, 710; National Credit Union Administration, Chartering and Field of Membership Manual (1994). It promulgates regulations concerning credit practices, 12 C.F.R. Part 706; dissemination of savings program information, 12 C.F.R. Secs. 707.1-707.6; payment of dividends, 12 C.F.R. Sec. 707.7; and inter alia, insurance and group purchasing plans, 12 C.F.R. Part 721. Finally, not unlike other executive branch agencies, the NCUA issues revised rulings which provide guidance to credit unions operating in the field. See 12 C.F.R. Ch. VII (1-1-95 Edition).

The decentralized system in which federal credit unions operate does not minimize the significance of NCUA's regulatory acts, the weight to be accorded the Federal Credit Union Act's careful delineation of federal credit union powers, or the significance of the other statutes governing federal credit union activities. See e.g. Truth in Lending Act, 15 U.S.C. Sec. 1601 et seq.; Equal Credit Opportunity Act, 15 U.S.C. Sec. 1601 et seq.; Fair Credit Reporting Act, 15 U.S.C. Sec. 1681 et seq.; Home Mortgage Disclosure Act, 12 U.S.C. Sec. 2801; and the Fair Debt Collection Practices Act, 15 U.S.C. Sec. 1692 et seq.

* * *

We hold, moreover, that performance of governmental functions, exemption from federal tax, and extensive government regulation are compelling indicia of federal instrumentality status.

* * *

Similarly, in United States v. State Tax Comm'n, 481 F.2d 963 (1st Cir.1973), we concluded that federal savings and loans associations are federal instrumentalities. 481 F.2d at 969; see also Federal Reserve Bank of Boston, 499 F.2d at 62. That case, like Federal Reserve Bank of Boston and many of the other cases involving questions of federal instrumentality status, concerned the validity of state taxes imposed on federal entities. See, e.g., United States v. Michigan, 851 F.2d at 803; Keifer and Keifer v. Reconstruction Finance Corp., 306 U.S. 381, 390 n. 3, 59 S.Ct. 516, 518-19 n. 3, 83 L.Ed. 784 (1939); United States v. Maine, 524 F.Supp. at 1056; United States v. California Bd. of Equalization, 2 Ca.State Tax Rep. (CCH), p 400-071, aff'd, 709 F.2d at 1518. We held that a Massachusetts tax imposed an impermissible burden on federal savings and loans because it provided a deduction for governmental institutions that were very similar to federal loan associations, but not for federal credit loan associations themselves. 481 F.2d at 963. In reaching our decision that such organizations are federal instrumentalities, we noted that federal savings and loans are federally created banks, chartered and regulated by an executive branch entity, the Federal Home Loan Board, and that "they serve the statutory purpose of providing 'local mutual thrift institutions in which people may invest their funds and ... for the financing of homes, ... [a] purpose ... said to affect the welfare of the nation as a whole." 481 F.2d at 967-78. Federal credit unions have similar characteristics and purposes.

* * *

We think it plain that federal credit unions are, as a general matter, federal instrumentalities.

* * *

Our analysis in this case does not end with our conclusion that federal credit unions are government instrumentalities.

> We must still resolve whether treating federal credit unions as federal instrumentalities and, thus, as government units, is consistent with the purposes of 11 U.S.C. section 523(a)(8).
>
> * * *
>
> We are convinced that treating federal credit unions as "government instrumentalities" and, thus, "government units," is consistent with Section 523(a)(8)'s discharge-limiting purpose.
>
> * * *
>
> We think it extremely unlikely that Congress ascribed a meaning to "government unit" which would frustrate not one, but two of its legislative enactments. Therefore, we hold that, federal credit unions are government units within the purpose and meaning of 11 U.S.C. Sec. 523(a)(8). [emphasis supplied]

Clearly, the First Circuit has accepted that extensive Federal regulation, even absent the appointment of any members of the board of directors, is sufficient to classify an entity as governmental. This is in marked contrast to the decision of the Ninth Circuit in the case at bar, quoted above, in which the Court held that extensive Federal regulation was insufficient to classify an entity as governmental absent the appointment of a majority of the board of directors by the Federal government.

It is therefore respectfully submitted that a conflict exists between the First and Ninth Circuits over the issue of whether extensive Federal regulation constitutes sufficient control to classify a quasi-governmental entity as sufficiently governmental to conclude that the entity owes private parties who deal with it the rights to which they are Constitutionally entitled. Accordingly, the instant petition should be granted, to enable this Court to rule on this issue, and resolve the conflict between the First and Ninth Circuits.

CONCLUSION

For the reasons stated above, it is respectfully requested that the Petition for a Writ of Certiorari be granted.

Respectfully submitted,
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APPENDIX A

Orders of the United States Court of Appeals for the Ninth Circuit

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

AMERICAN BANKERS MORTGAGE CORPORATION,

Plaintiff-Counter-Defendant-Appellant.

v.

FEDERAL HOME LOAN MORTGAGE CORPORATION, d/b/a Freddie Mac,

Defendant-Counter-Plaintiff-Appellee,

and

COUNTRYWIDE CREDIT INDUSTRIES, INC.,

Defendant-Appellee.

No. 94-55967.
D.C. No. CV-93-01168-WJR

United States Court of Appeals,
Ninth Circuit.
Argued and Submitted Nov. 14, 1995.
Filed Feb. 12, 1996.

Appeal from the United States District Court for the Central District of California William J. Rea, District Judge, Presiding

James L. Lysaght, Lysaght, Lysaght & Kramer, Lake Success, New York, for the plaintiff-counter-defendant-appellant.

Howard Lindenberg, Federal Home Loan Mortgage Corporation, McLean, Virginia, for the defendant-counter-plaintiff-appellee.

Before: Betty B. FLETCHER, William C. CANBY, Jr., and Michael Daly HAWKINS, Circuit Judges.

OPINION

FLETCHER, Circuit Judge:

*1 American Bankers Mortgage Corporation ("ABM") appeals a district court judgment dismissing certain of its claims for failure to state a claim, granting summary judgment against it on its remaining claims, and granting summary judgment for the Federal Home Loan Mortgage Corporation ("Freddie Mac") on certain of its counterclaims. We have jurisdiction under 28 U.S.C.§1291 and affirm.

FACTUAL BACKGROUND

Freddie Mac, a federally chartered corporation, purchases home mortgages from lenders and sells securities to the public to fund the purchases. Mortgages are only purchased from, and serviced by, approved seller/servicers under the terms of contracts, the most important document of which is the Sellers' & Servicers' Guide, a two-volume looseleaf publication. The Guide sets forth standards and requirements with which a seller/servicer must comply in order to sell mortgages to, and service mortgages for, Freddie Mac. For example, seller/servicers must provide certain complete and accurate reports to Freddie Mac, maintain certain accounting records,

maintain specified underwriting and quality control procedures, and maintain delinquency rates within certain limits. The Guide provides that Freddie Mac may terminate a seller/servicer's approval at its discretion for breach of any representation or warranty required of it by the Guide.

ABM, a mortgage banking corporation organized and licensed under California law, became an approved Freddie Mac seller/servicer in October 1983. In December 1991 outside auditors found that ABM was underreporting to Freddie Mac delinquencies on the mortgages it serviced. Although ABM claims that the reporting requirement was unclear as to the definition of reportable delinquencies, the auditor found underreporting even under the interpretation most favorable to ABM. In October 1991, for example, ABM should have reported 98 delinquencies under its interpretation rather than the 20 it did report, and the outside auditor (and Freddie Mac) read the Guide to require that some 220 loans should have been reported as delinquent. ABM later admitted the underreporting and provided figures for November and December 1991 indicating that 244 and 247 delinquencies, respectively, had gone unreported under Freddie Mac's interpretation of the Guide requirements. The company asserted that the underreporting resulted entirely from unauthorized action by a single employee, ABM's executive vice-president and servicing manager. The audit also found that ABM's custodial bank account for Freddie Mac contained improperly commingled funds in violation of the Guide requirements.

ABM notified Freddie Mac of the reporting problem and made several attempts to persuade Freddie Mac to allow it to remedy its failure to comply with Guide standards and requirements, but in February 1992 Freddie Mac suspended ABM's seller/servicer eligibility pending an investigation and then terminated ABM's status as a seller/servicer for 13 enumerated reasons, including ABM's failure to submit accurate delinquency

reports, its violation of its obligation not to misstate or omit any material fact in any representation to Freddie Mac, its unacceptably high delinquency rate, its failure to maintain adequate quality control, and its commingling of funds. At the time Freddie Mac gave oral notice of termination, it apparently repossessed documents relating to over 3,000 loans, allegedly including some loans being serviced by ABM for owners other than Freddie Mac. ABM alleges that Freddie Mac transferred the servicing of its loans to Countrywide Credit Industries. Freddie Mac also seized a custodial account held by ABM for Freddie Mac containing over $4 million, $500,000 of which allegedly did not belong to Freddie Mac.

*2 In March 1992, ABM filed with Freddie Mac an appeal of its termination as allowed by the Guide, conceding the validity of "many" of the reasons for termination given in the February notice but asserting that the violations resulted from oversight rather than intentional or reckless management conduct. Freddie Mac denied the appeal in April 1992.

In June 1992, Freddie Mac demanded that ABM pay it $1,269,963.46 allegedly due Freddie Mac on the mortgages formerly serviced by ABM, but ABM has not paid any portion of this sum.

PROCEEDINGS BELOW

In March 1993, ABM filed a complaint in the Central District of California against Freddie Mac and Countrywide Credit alleging breach of contract, tortious breach of an implied covenant of good faith and fair dealing, violation of Fifth Amendment due process rights, conversion, and forfeiture. On May 12, 1993 the district court granted Freddie Mac's motion to dismiss for failure to state a claim the counts of tortious breach and due process violations. A motion by ABM to reconsider the dismissal was denied in September 1993.

On May 28, 1993, Freddie Mac filed a counterclaim for breach of contract, negligent misrepresentation, conversion, specific recovery of personal property, and the establishment of a constructive trust.

After discovery ended in January 1994, Freddie Mac and Countrywide moved in February 1994 for summary judgment in their favor on the remaining counts of ABM's complaint and on the breach of contract and specific recovery counts of the counterclaim. On June 8, 1994 the District court granted the motion, dismissing most of ABM's claims against both defendants and awarding Freddie Mac $1,947,076.47, together with interest and costs. On June 9, 1994, the court entered a stipulation and order by which the parties voluntarily dismissed ABM's one remaining claim for conversion of $500,000 and Freddie Mac's three remaining claims; Freddie Mac agreed to set the $500,000 off against its $1.9 million award, which it apparently viewed as largely uncollectible.

STANDARD OF REVIEW

Dismissal for failure to state a claim on which relief can be granted is reviewed de novo. Stone v. Travelers Corp., 58 F.3d 434, 436-37 (9th Cir.1995). A grant of summary judgment is also reviewed de novo. Jesinger v. Nevada Fed. Credit Union, 24 F.3d 1127, 1130 (9th Cir.1994).

DISCUSSION

I. Freddie Mac's Actions Were Not Subject to the Fifth Amendment

Appellant asserts that the district court erred in concluding that its allegation that Freddie Mac violated its Fifth Amendment rights by terminating its eligibility without due process

failed to state a claim. Because the Fifth Amendment Due Process Clause applies only to the federal government, Public Utilities Commission v. Pollak, 343 U.S. 451, 461 (1952), Freddie Mac is not restricted by that Clause unless it is part of the federal government or its actions constituted federal action. We conclude that neither is the case.

A. Freddie Mac Is Not a Government Entity

*3 The Supreme Court's recent decision in Lebron v. National Railroad Passenger Corp., __ U.S. __, 115 S.Ct. 961 (1995), provides the appropriate framework for analysis of Freddie Mac's governmental status. The Court there held that "where ... the Government creates a corporation by special law, for the furtherance of governmental objectives, and retains for itself permanent authority to appoint a majority of the directors of that corporation, the corporation is part of the Government for purposes of the First Amendment." Id. at 974-75. Since Freddie Mac is a corporation chartered by Congress, the two relevant criteria for judging Freddie Mac's status as a federal entity for Fifth Amendment purposes are the extent to which its objectives are governmental and the extent to which the government directs and controls the corporation's pursuit of those objectives.

1. Objectives

The Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA) wrote the purposes of Freddie Mac into law for the first time.[1] In the Federal Housing Enterprises

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[1]As modified by the Federal Housing Enterprises Financial Safety and Soundness Act of 1992, Pub.L. 102-550, §1382(a), 106 Stat. 4002 (1992), those provisions of FIRREA state:

(continued...)

Financial Safety and Soundness Act of 1992, Congress emphasized the public nature of these purposes.[2] The congressional

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[1](...continued)

"It is the purpose of the Federal Home Loan Mortgage Corporation -

"(1) to provide stability in the secondary market for residential mortgages;

"(2) to respond appropriately to the private capital market;

"(3) to provide ongoing assistance to the secondary market for residential mortgages (including activities relating to mortgages on housing for low- and moderate-income families involving a reasonable economic return that may be less than the return earned on other activities) by increasing the liquidity of mortgage investments and improving the distribution of investment capital available for residential mortgage financing; and

"(4) to promote access to mortgage credit throughout the Nation (including central cities, rural areas, and underserved areas) by increasing the liquidity of mortgage investments and improving the distribution of investment capital available for residential mortgage financing."

12 U.S.C.§1451 note.

Appellants argue that the statute's grant to Freddie Mac of the "power ... to make and enforce such bylaws, rules, and regulations as may be necessary or appropriate to carry out the purposes or provisions of this chapter", 12 U.S.C.§1452(c)(3) makes Freddie Mac a government entity because making and enforcing regulations to carry out provisions of the U.S.Code is a uniquely governmental prerogative. This grant, however, appears to be nothing more than the standard language authorizing a corporation to carry out the purposes for which it was incorporated. *Lebron* therefore indicates that the relevant issue is not merely the fact that those purposes appear in the Code but rather whether those purposes are in fact federal governmental objectives.

[2]"The Congress finds that-

"(1) the Federal National Mortgage Association and the Federal Home

(continued...)

purposes for Freddie Mac are clearly designed to serve the public interest by increasing the availability of mortgages on housing for low- and moderate-income families and by promoting nationwide access to mortgages. At least one Court of Appeals has held that Freddie Mac "certainly furthers an important federal mission, and does act as a federal agency or instrumentality in this sense". Mendrala v. Crown Mortgage Co., 955 F.2d 1132, 1139 (7th Cir.1992) (finding Freddie Mac nonetheless not a federal agency for claims under the Federal Tort Claims Act). The Mendrala court also found Freddie Mac's purposes sufficiently governmental to qualify the corporation to enjoy protection from estoppel under the doctrine of Federal Crop Ins. Corp. v. Merrill, 332 U.S. 380 (1947): "The FHLMC has a public statutory mission: to maintain the secondary mortgage market and assist in meeting low- and moderate-income housing goals." 955 F.2d at 1140-41 (footnote omitted) (emphasis added). Thus, Freddie Mac's purposes are "federal governmental objectives" for the purpose of analyzing whether or not Freddie Mac is a government entity.

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[2](...continued)
Loan Mortgage Corporation ... and the Federal Home Loan Banks ... have important public missions that are reflected in the statutes and charter Acts establishing [them];

"(2) ... the continued ability of the Federal National Mortgage Association and the Federal Home Loan Mortgage Corporation to accomplish their public missions is important to providing housing in the United States and the health of the Nation's economy ...

"(7) the Federal National Mortgage Association and the Federal Home Loan Mortgage Corporation have an affirmative obligation to facilitate the financing of affordable housing for low- and moderate-income families ..." 12 U.S.C.§4501.

2. Control

The government, however, does not "control[ ] the operation of [Freddie Mac] through its appointees", Lebron, __ U.S. at __, 115 S.Ct. at 974. Freddie Mac's board of directors consists of 18 persons, of whom 13 are elected annually by the voting common shareholders.[3] 12 U.S.C.§1452(a)(2)(A). Freddie Mac has apparently issued nearly 60 million common shares of stock, and its shares are publicly traded on the New York Stock Exchange. Amtrak, by contrast, had only four private shareholders at the time Lebron was decided. __ U.S. at __, 115 S.Ct. at 968. Freddie Mac's five remaining directors are appointed annually by the President, independently of the Senate. Thus, the U.S. government is entitled to appoint fewer than one-third of Freddie Mac's directors. Although the President must choose at least 1 director from each of four categories (the homebuilding industry, the mortgage lending industry, the real estate industry, and the consumer or low- income-housing communities), 12 U.S.C. §1452(a)(2)(A), these provisions appear to be irrelevant to the issue of government control under Lebron, since the Court there viewed analogous requirements for presidential appointments to Amtrak's board as only "a restriction imposed by one of the political branches upon the other". Lebron, __ U.S. at __, 115 S.Ct. at 973.

***4** On the other hand, the law governing Amtrak effectively provided at the time of Lebron for complete government control

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[3]The current governance structure was created by FIRREA, which dramatically overhauled Freddie Mac. Before FIRREA, Freddie Mac was governed by a three-member board of directors, composed of the members of the Federal Home Loan Bank Board. Pub.L. 91-351,§303, 84 Stat. 452 (1970). Freddie Mac's stock was to be issued only to Federal home loan banks. Id. at §304.

of that corporation's board, which consists of nine members: the Secretary of Transportation (ex officio); three directors chosen for four-year terms by the President with the advice and consent of the Senate; two directors appointed for two-year terms by the President with no Senate involvement; two directors elected for one-year terms by the holders of preferred stock, all of which was owned by the United States at the time of the decision in Lebron, __ U.S. at __, 115 S.Ct. at 968; and Amtrak's president, who is appointed by the Board itself and serves at its pleasure. 49 U.S.C.§24302.[4] The Lebron Court noted that "Amtrak's four private shareholders have not been entitled to vote in selecting the board of directors since 1981". __ U.S. at __, 115 S.Ct. at 968. Given that "six of the corporation's eight externally named directors ... are appointed directly by the President of the United States— four of them ... with the advice and consent of the Senate", id. at 973, the Court concluded that Amtrak was a government-controlled corporation.

The current governance structure of Freddie Mac affords the government far less control over that corporation's operations than it had over Amtrak's operations in Lebron. Freddie Mac is far more analogous to the Communications Satellite Corporation (Comsat); only 3 of Comsat's 15 directors are appointed by the President. 47 U.S.C.§733(a). The Lebron Court found Comsat to be "genuinely private". Id. (emphasis in original). Thus, the second element of the Lebron test for determining whether a federally chartered corporation is a federal entity, the government's control over the corporation, is missing in this case.

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[4]In 1994, as part of a comprehensive revision of the portions of the U.S.Code relating to transportation, the statute governing Amtrak was revised and reenacted as part of Title 49. See 49 U.S.C.§24301 et seq. The provisions that now appear at 49 U.S.C.§24302 correspond to the pre-revision 45 U.S.C.§543, the section quoted from and cited to in Lebron.

ABM argues that Freddie Mac is a federal agency because 12 U.S.C. §1452(f) provides that the corporation "shall be deemed to be an agency included in sections 1345 and 1442 of ... Title 28". Those sections of the judicial code grant federal district courts original jurisdiction over suits "commenced ... by any agency", 28 U.S.C. §1345, and removal jurisdiction over suits "commenced in a State court against any ... officer of the United States or any agency thereof", 28 U.S.C. §1442. The fact that Congress felt it necessary to provide in Freddie Mac's governing statute that the corporation shall be deemed an agency under those provisions—"[n]otwithstanding section 1349 of Title 28", 12 U.S.C. §1452(f), which provides that mere federal incorporation shall not confer federal jurisdiction—demonstrates that Congress did not believe that Freddie Mac was an "agency", at least for Title 28 purposes. Further, federal jurisdiction for suits for or against the corporation is only one factor to be considered in determining the governmental purposes and control of a federally chartered corporation.

***5** Two cases cited by ABM in support of finding Freddie Mac a governmental entity are not relevant because both were decided before FIRREA restructured Freddie Mac and neither squarely addressed whether Freddie Mac was subject to constitutional provisions such as the Fifth Amendment. Rocap v. Indiek, 539 F.2d 174, 176 (D.C.Cir.1976) (Freddie Mac was a "Government controlled corporation" under 5 U.S.C.§552(e) and subject to FOIA because corporation's board "is composed of the three members of the Federal Home Loan Bank Board ... and its capital stock is non-voting and held solely by the twelve Federal Home Loan Banks"); McCauley v. Thygerson, 732 F.2d 978, 982 (D.C.Cir.1984) (Freddie Mac's status for purpose of employment relations "ultimately turn[ed] ... on functional considerations of the effect that application of broad notions of promissory estoppel would have in light of the congressional intent expressed in FHLMC's enabling act"). Even the Seventh

Circuit's opinion in Mendrala is of little relevance, since its findings that Freddie Mac both was and was not a federal agency or instrumentality were expressly confined to the particular contexts of the Federal Tort Claims Act and the Merrill doctrine, respectively. Moreover, two district courts, in addition to the one that decided this case, have expressly found that Freddie Mac's termination of a seller/servicer was not subject to the Fifth Amendment. Liberty Mortgage Banking, Ltd. v. Federal Home Loan Mortgage Corp., 822 F.Supp. 956, 958-60 (E.D.N.Y.1993) (Freddie Mac was private corporation rather than government agency; decision to terminate plaintiff as seller/servicer could not be deemed government action); FBMC Fin., Inc. v. Federal Home Loan Mortgage Corp., No. 91 cv. 1226-R (S.D.Cal. Sept. 26, 1991) (discussed in Liberty Mortgage, 822 F.Supp. at 960). In addition, two other circuits have held that the Federal National Mortgage Association ("Fannie Mae") is not subject to the Fifth Amendment Due Process Clause. Northrip v. Federal National Mortgage Ass'n, 527 F.2d 23, 30 (6th Cir.1975) (corporation was federally chartered and regulated but stock traded on New York Stock Exchange and only 5 of 15 directors were appointed by President); Roberts v. Cameron-Brown Co., 556 F.2d 356, 359 (5th Cir.1977) (relying on Northrip and holding that FNMA's activities did not qualify as governmental action).

While Freddie Mac is chartered to pursue federal governmental objectives, the level of government control over the corporation is so much lower than that exercised over Amtrak we conclude that, upon an application of Lebron principles, that Freddie Mac is not a government agency subject to the Fifth Amendment's Due Process Clause.

B. Freddie Mac's Actions Did Not Constitute Federal Action for Constitutional Purposes

ABM argues that even if Freddie Mac is not a governmental entity, its actions in terminating appellants as seller/servicers should be subject to the requirements of the Fifth Amendment's Due Process Clause because the terminations were federal action. "The standards utilized to find federal action for purposes of the Fifth Amendment are identical to those employed to detect state action subject to the strictures of the Fourteenth Amendment." Geneva Towers Tenants Org. v. Federated Mortgage Investors, 504 F.2d 483, 487 (9th Cir.1974). Because the Court's consideration of the state action question in San Francisco Arts & Athletics, Inc. v. United States Olympic Committee, 483 U.S. 522 (1987), is both recent and involved a federally chartered corporation, it provides the most appropriate standards for analysis in this case.[5] The San Fran

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[5]The Supreme Court itself noted in Lebron that "[i]t is fair to say that 'our cases deciding when private action might be deemed that of the state have not been a model of consistency' ". __ U.S. at __, 115 S.Ct. at 964 (quoting Edmonson v. Leesville Concrete Co., 500 U.S. 614, 632 (1991) (O'Connor, J., dissenting)). In recent cases other than San Francisco Arts & Athletics, the Court has suggested a somewhat different, two-step approach to determining when "conduct allegedly causing the deprivation of a federal right [can] be fairly attributable" to a state government: First, the deprivation must be caused by the exercise of some right or privilege created by the State or by a rule of conduct imposed by the State or by a person for whom the State is responsible.... Second, the party charged with the deprivation must be a person who may fairly be said to be a state actor. Lugar v. Edmondson Oil Co., 457 U.S. 922, 937 (1982) (considering whether respondent's prejudgment attachment of petitioner's property under state ex parte proceeding constituted state action). See also Georgia v. McCollum, 505 U.S. 42, 50-55

(continued...)

cisco Arts & Athletics Court examined (1) the nexus between the government and the challenged action, (2) whether the alleged government actor performed functions traditionally exclusively reserved to the government, and (3) whether the government coerced or encouraged the challenged action. Id. at 543-46.

1. Nexus

*6 Appellant suggests a nexus between the government and Freddie Mac's termination by reciting a litany of U.S. government regulations applicable to Freddie Mac.[6] However, "[e]ven

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[5](...continued)
(1992) (finding a state criminal defendant's exercise of peremptory challenges constitutes state action for equal protection purposes); Edmonson v. Leesville Concrete Co., 500 U.S. 614, 619-28 (1991) (finding a federal civil litigant's exercise of peremptory challenges constitutes state action for equal protection purposes). The discussion of federal action in San Francisco Arts & Athletics, which involved a fact pattern much more similar to that involved here than any of these "two-step" cases, made no mention of the framework set forth five years earlier in Lugar.

[6]These include: * limits on whom the President can appoint to the corporation's board, 12 U.S.C.§1452(a)(2)(A); * requirements that Freddie Mac submit reports to Congress and to the Department of Housing and Urban Development (HUD), 12 U.S.C. §§1452(h)(1), 1456(c), 1456(f); * Cabinet oversight of provisions of its executive employment agreements, 12 U.S.C.§1452(h)(2); * limits on the original principal obligations of the mortgages it purchases, 12 U.S.C.§1454(a)(2); * requirements for Cabinet approval of unsecured borrowing or debt obligations, 12 U.S.C. §§1455(j)(1), 1455(k)(1); * audits by the Comptroller General, 12
(continued...)

extensive regulation by the government does not transform the actions of the regulated entity into those of the government". San Francisco Arts & Athletics, 483 U.S. at 544 (citing Jackson v. Metro. Edison Co., 419 U.S. 345 (1974)). The Jackson Court explained that even "extensive and detailed [regulation], as in the case of most public utilities" does not turn private action into state action. 419 U.S. at 350. Instead, "the inquiry must be whether there is a sufficiently close nexus between the State and the challenged action of the regulated entity so that the action of the latter may be fairly treated as that of the State itself". Id. at 351. The regulations regarding Freddie Mac appear substantially less "extensive and detailed" than those typically imposed on public utilities. More importantly, ABM has failed to allege any nexus between those regulations and the challenged actions by Freddie Mac, i.e., the termination of ABM as a seller/servicer. Cf. Rendell-Baker v. Kohn, 457 U.S. 830, 841 (1982) (petitioners challenging discharge by private school had not shown decisions were compelled or even influenced by state regulation; in contrast to extensive regulation of school generally, regulators showed little interest in personnel matters). Although appellant points to the requirement of 12 U.S.C.§1456(f)(2)(J) that Freddie Mac report to Congress and HUD on, among other matters, the race and gender of approved seller/servicers, they offer no suggestion of how this requirement

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[6](...continued)
U.S.C.§1456(b)(1); * a requirement to appoint an Affordable Housing Advisory Council, 12 U.S.C.§1456(g); * mandated goals of the dollar amount and proportion of mortgages to be purchased by Freddie Mac that are for properties affordable to low- and moderate-income buyers, 12 U.S.C.§4563(d)(2); and * mandated goals of the proportion of mortgages to be purchased by Freddie Mac that are for properties in central cities, 12 U.S.C.§4564(d).

might even be related to the particular termination decisions challenged here, let alone how this requirement presents a sufficiently close nexus for state action purposes. Cf. Liberty Mortgage, 822 F.Supp. at 959 ("[N]o federal agency exercises any oversight or regulatory control over the day-to-day decision making of Freddie Mac. Thus, there is not a sufficiently close nexus between Freddie Mac's decision to terminate Liberty and the federal government to treat the termination as government action.").

2. Exclusively Governmental Nature of Function

The second factor to be considered is whether "the challenged entity performs functions that have been" 'traditionally the exclusive prerogative' " of the Federal Government", San Francisco Arts & Athletics, 483 U.S. at 544 (quoting Rendell-Baker, 457 U.S. at 842 (quoting Jackson, 419 U.S. at 353)). While Freddie Mac's objective of increasing the affordability of housing is clearly governmental, performance of activities that serve a national interest does not in itself constitute federal action. Id. at 545. The powers exercised by Freddie Mac in participating in the secondary market for mortgages and improving access to home loans for low--and moderate-income families hardly qualify as powers "traditionally associated with sovereignty, such as eminent domain". Jackson, 419 U.S. at 353. Cf. Flagg Bros., Inc. v. Brooks, 436 U.S. 149, 158 (1978) ("While many functions have been traditionally performed by governments, very few have been 'exclusively reserved to the State' ".). Indeed, Freddie Mac's functions would not even seem to rise to the level of functions such as "education, fire and police protection, and tax collection", functions Flagg Bros. expressly declined to decide were sufficiently exclusive that a private actor's performance of such functions would constitute state action. 436 U.S. at 163-64.

3. Coercion or Encouragement

*7 The final element in determining federal action by a federally chartered corporation is whether, with regard to the challenged decision, the government " '... has exercised coercive power or has provided such significant encouragement, either overt or covert, that the choice must in law be deemed to be that of the [government]' ". San Francisco Arts & Athletics, 483 U.S. at 546 (quoting Blum v. Yaretsky, 457 U.S. 991, 1004 (1982)). Again, however, appellants point to no evidence suggesting that the federal government in any way coerced or encouraged Freddie Mac to terminate them as seller/servicers. The fact that the government requires Freddie Mac to report on the race and gender of its seller/servicers might be some encouragement (though perhaps not significant enough for the federal action test) for the corporation to terminate seller/servicers on the basis of one of those characteristics, but ABM made absolutely no allegations that the termination challenged here was made for racial or gender reasons. Cf. Liberty Mortgage, 822 F.Supp. at 959 ("[P]laintiff does not allege that the federal government in any way compelled Freddie Mac's action. Indeed, there is no allegation that any federal employee or official participated in, or even had any prior knowledge of, Freddie Mac's decision to terminate Liberty.")

Thus, Freddie Mac's termination of appellants does not constitute federal action subject to the requirements of the Fifth Amendment Due Process Clause. The district court's dismissal for failure to state a claim on the grounds that the termination was not government action was correct.

II. State-Law Claims[7]

A. Conversion

ABM argues that it had at the least a right of possession to the servicing rights in the portfolio of mortgages it serviced for Freddie Mac and that Freddie Mac's transfer of those servicing rights constituted conversion.

ABM is correct that under California law a claim of conversion will lie even if the allegedly converted property is intangible. See, e.g., A & M Records, Inc. v. Heilman, 142 Cal.Rptr. 390, 400 (Cal.Ct.App.1977), cert. denied 436 U.S. 952 (1978) (sound recordings); Lone Ranger Television, Inc. v. Program Radio Corp., 740 F.2d 718, 726 (9th Cir.1984) (applying California law) (sound recordings); Swim v. Wilson, 27 P. 33, 34 (Cal.1891) (corporate shares); Fiedler v. Allen, 4 P.2d 292, 293 (Cal.Ct.App.1931) (bonds). Under California law, however, not all intangible property is the proper subject of claims of conversion. See, e.g. Adkins v. Model Laundry Co., 268 P. 939, 942 (Cal.Ct.App.1928) (no conversion of laundry route); Olschewski v. Hudson, 262 P. 43, 45 (Cal.Ct.App.1927) (no conversion of customer list). Even if we assume, without deciding, that the mortgage servicing rights at issue here are the proper subject of a conversion claim, ABM as a matter of law cannot prove such a claim.

"The elements of a conversion cause of action [in California] are (1) plaintiffs' ownership or right to possession of the property at the time of the conversion; (2) defendants' conversion by a wrongful act or disposition of plaintiffs' property rights; and (3) damages." Baldwin v. Marina City Properties,

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[7]All parties have assumed, without discussion, that California law applies to the remaining claims.

Inc., 145 Cal.Rptr. 406, 416 (Cal.Ct.App.1978). ABM has not raised a genuine issue of material fact as to its right to possess the mortgage servicing rights at the time that Freddie Mac transferred those rights to other servicers.

*8 ABM's status as a seller/servicer and its relationship with Freddie Mac were governed by contract. Each contract included the Sellers' and Servicers' Guide. That document provides that "[m]ortgages purchased by Freddie Mac must be serviced by a Servicer". Guide, §6201(a). Under the contracts then, ABM had no right to service any mortgage owned by Freddie Mac unless it was a "Servicer". The Guide defines a "Servicer" as "a Seller/Servicer acting in its capacity as a servicer of mortgages for Freddie Mac", and defines a "Seller/Servicer" as "an institution approved to sell mortgages to, and to service mortgages purchased by, Freddie Mac". Guide, § 0230. Thus, unless an entity is approved by Freddie Mac as a Seller/Servicer, it has no right to service mortgages purchased by Freddie Mac.

While Freddie Mac had approved ABM as a seller/servicer, it terminated ABM's eligibility to sell and service mortgages, pursuant to Guide §§0402, 0403, and 6309, by oral notice, effective immediately, followed by written confirmation. Upon termination, ABM ceased to be a "Seller/Servicer" and by the terms of the contract had no right to service mortgages owned by Freddie Mac. Therefore, ABM had no remaining possessory interest in the servicing rights to its mortgage portfolio and cannot establish the first element of a conversion claim.

ABM also argues that summary judgment on its claim of conversion was improper because the contractual provisions that the district court found entitled Freddie Mac to terminate its eligibility as a seller/servicer were unconscionable terms of contracts of adhesion. California law defines a contract of adhesion as " '... a standardized contract, which, imposed and drafted by the party of superior bargaining strength, relegates to the subscribing party only the opportunity to adhere to the

contract or reject it' ". Graham v. Scissor-Tail, Inc., 623 P.2d 165, 171 (Cal.1981) (quoting Neal v. State Farm Ins. Cos., 10 Cal.Rptr. 781, 784 (Cal.Ct.App.1961)). The contracts may well meet the California definition of adhesion. The fact that ABM negotiated certain waivers for each of its Master Commitment Contracts with Freddie Mac does not prevent other provisions of the contract from being classified as adhesive. Graham, 623 P.2d at 172 ("The terms here asserted to be subject to negotiation, assuming that they were in fact so, were of relatively minor significance in comparison to those imposed by [the other party] ... In these circumstances we cannot conclude that the presence of other assertedly negotiable terms acted to remove the taint of adhesion.").

Even if we assume that the contracts are adhesive, ABM cannot show that the termination provisions should not be enforced. A contract of adhesion is fully enforceable in California unless in whole or in part it "does not fall within the reasonable expectations of the weaker or 'adhering' party" or is "unduly oppressive or 'unconscionable' ". Id. at 172-73. ABM cannot show that the termination provisions were not within its reasonable expectations. Like the plaintiff in Graham, ABM had, over the course of its relationship with Freddie Mac, signed a number of Master Commitment Contracts governed by substantially the same Guide provisions and clearly had an "awareness" (though not as "abiding" as that in Graham) of those provisions. Graham, 623 P.2d at 173.

***9** ABM bears the burden of raising a triable issue of fact as to unconscionability, although the procedural posture of the issue in this case is somewhat unusual. Westlye v. Look Sports, Inc., 22 Cal.Rptr.2d 781, 792 (Cal.Ct.App.1993) (unconscionability is a question of law, but its resolution turns on factual circumstances of case). The California cases usually have involved a defense to the enforcement of a contract. In this case, ABM sued Freddie Mac for conversion, Freddie Mac defended

by arguing that under the contracts ABM retained no rights in the mortgage portfolios once its eligibility was terminated, and ABM then defended against the defense by asserting that the contract was adhesive and unconscionable. This was the precise posture in which the issues arose in Westlye, in which the plaintiff sued defendants in tort for injuries suffered in a skiing accident, defendants defended against the claim by introducing the equipment rental agreement that plaintiff had signed (in which plaintiff released the lessor from liability and assumed the risk), and the plaintiff raised the adhesion and unconscionability of the contract as "a defense to the defense". 22 Cal.Rptr.2d at 793. The court there held that a plaintiff raising such a "defense to the defense" had the burden to raise a triable issue of material fact to make unconscionability an issue.[8] Id. at 795.

ABM has not made a showing of unconscionability sufficient to survive summary judgment. One factor in the unconscionability determination is "the absence of meaningful choice", Perdue v. Crocker Nat'l Bank, 702 P.2d 503, 513 (Cal.1985), appeal dismissed, 475 U.S. 1001 (1986). At least one California court has held that "any claim of 'oppression' may be defeated if the complaining party had reasonably available alternative sources of supply from which to obtain the desired goods or services free of the terms claimed to be unconscionable". Dean Witter Reynolds, Inc. v. Superior Court, 259 Cal.Rptr. 789, 795 (Cal.Ct.App.1989); see also Kurashige v. Indian Dunes, Inc., 246 Cal.Rptr. 310, 314 (Cal.Ct.App.1988). In the hearing on Freddie Mac's motion for summary judgment, the court asked

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[8]Since the Westlye court had earlier held unconscionability to be a question of law to be determined based on "the factual circumstances of the case", this holding appears to mean that a plaintiff must create a genuine issue of material fact as to circumstances from which a court could find the contract adhesive and the challenged provision unconscionable.

counsel for ABM if Freddie Mac was "the only place that they can sell these mortgages". The attorney responded that "[t]o a large extent that is the case" and that "there is no private entity to which it can in turn sell these mortgages". Freddie Mac's counsel asserted that ABM was in fact selling mortgages to Fannie Mae and Ryland Acceptance Corporation, and that other secondary market investors existed. Although neither party appears to have provided evidentiary support for its assertions, ABM's complaint admits that it "was approved to originate, service, and sell loans" by Fannie Mae, the Veteran's Administration (VA), and the Federal Housing Authority (FHA). ABM admits that Fannie Mae buys mortgages, but argues that Freddie Mac "offers a pricing advantage over Fannie Mae" such that a company that sold only to Fannie Mae could not compete in the marketplace. The fact that a buyer or seller is the only source not of a particular product or service but of a particular price advantage is an insufficient argument for unconscionability where alternative sources for the product or service exist.

***10** The real question is whether Fannie Mae and all other investors in the secondary mortgage market impose the same termination provisions as those in Freddie Mac's contracts with its seller/servicers, since the issue is whether other entities existed that would buy mortgages and mortgage servicing from ABM "free of the terms claimed to be unconscionable". Dean Witter Reynolds, 259 Cal.Rptr. at 795. No evidence was presented on that question. Since ABM asserted unconscionability as a defense to Freddie Mac's contract defense to the conversion claim, it was incumbent upon ABM to make some showing that a genuine issue of fact existed as to the question of alternative sources.

ABM also appears to press on appeal its allegations of conversion of approximately $500,000 that was commingled with Freddie Mac funds in custodial accounts. Appeal of the merits of this claim is improper since it was dismissed with

prejudice by stipulation of the parties as part of an agreement dismissing all claims remaining in the complaint and cross-complaint after summary judgment and offsetting $500,000 against the $1.9 million judgment in favor of Freddie Mac.

B. Relief From Forfeiture

California Civil Code §3275 provides for relief, under certain circumstances, where a party's failure to comply with the provisions of a contract results in a forfeiture.[9] The party in default must plead and prove facts entitling it to relief under the section. Barkis v. Scott, 208 P.2d 367, 370 (Cal.1949).

ABM argues that the district court's grant of summary judgment on its claims for relief from forfeiture was improper because genuine issues of fact existed as to whether ABM was guilty of "grossly negligent, willful, or fraudulent breach of duty" so as to preclude the application of §3275 and whether appellees were unjustly enriched, which under California law might allow the court to order restitution to appellants even if §3275 did not apply.

The district court granted summary judgment on the grounds that §3275, which it found was intended "to relieve a defaulting purchaser from the odious burden of losing previous installment payments by virtue of a default on a single, subsequent payment", did not apply to this situation because Freddie Mac's termination of ABM did not deprive ABM of the benefit of any previous payments. It also held that under California law, §3275 requires "some measurable enrichment of defendant from which

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[9]The full text of the section reads: "Whenever, by the terms of an obligation, a party thereto incurs a forfeiture, or a loss in the nature of a forfeiture, by reason of his failure to comply with its provisions, he may be relieved therefrom, upon making full compensation to the other party, except in case of a grossly negligent, willful, or fraudulent breach of duty."

the damage suffered by him is to be deducted", Lines v. Marin Mun. Water Dist., 39 Cal.Rptr. 294, 297 (Cal.Ct.App.1964), and that Freddie Mac was not enriched in any way by transferring ABM's mortgage portfolios to other seller/servicers.

Even if we assume that §3275 applies, Freddie Mac is entitled to summary judgment on the ground that §3275 requires that a party seeking relief must make full compensation for its failure to comply with the provisions of the contract. In its motion for summary judgment, Freddie Mac provided deposition testimony by Richard H. Johnson, ABM's president and CEO, that ABM had never made any offer of payment in response to Freddie Mac's demand for $1.2 million owed it because of "misapplication of payments, ... account shortages, and payments received that ha[d] not been forwarded to [Freddie Mac's] interim servicer". In opposing Freddie Mac's motion for summary judgment on this point, ABM offered no evidence to controvert this point. As a result, even if §3275 applies to this situation, ABM has failed to demonstrate its right to relief under that section.

***11** ABM argues that it has a triable claim for relief from forfeiture against Countrywide Credit. This appears to be a new argument on appeal, as the company's original claim for relief from forfeiture never mentioned Countrywide. Indeed, the district court's conclusions of law in support of its summary judgment treat the conversion claim as the only one involving Countrywide. Even if the original complaint were construed so liberally as to include claims for relief from forfeiture against Countrywide, such a claim would fail as a matter of law. Section 3275 addresses forfeiture resulting from failure to comply with the provisions of an "obligation" and only applies to the parties to the obligation. There is no evidence whatsoever that any contract existed between ABM and Countrywide.

CONCLUSION

Because Freddie Mac is not a federal entity and its termination of ABM's status as a seller/servicer was not federal action, the dismissal of appellant's due process claims is affirmed. Because appellant has created no genuine triable issue of material fact as to its conversion or relief from forfeiture claims, summary judgment on those claims is also affirmed.

NOT FOR PUBLICATION
UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

MORTGAGE NETWORK, INC.,

Plaintiff-counter-defendant-Appellant,

and

MORTGAGE NETWORK SERVICING PARTNERS; MORTGAGE NETWORK SERVICING PARTNERS II; ROBERT LAMB,

Plaintiffs-counter-defendants,

v.

THE FEDERAL HOME LOAN MORTGAGE CORPORATION, d/b/a Freddie Mac,

Defendant-counter-claimant-Appellee,

and

TRIDATION SOFTWARE SERVICES, INC.; BISYS, INC.,

Defendants.

No. 94-55996
D.C. NO. CV-93-00303-LHM

MEMORANDUM*

Appeal from the United States District Court
for the Central District of California
Linda H. McLaughlin, District Judge, Presiding

Argued and Submitted November 14, 1995
Pasadena, California

Before: FLETCHER, CANBY, and HAWKINS, Circuit Judges

No. 94-55996
D.C. No. CV-93-00303-LHM

*This disposition is not appropriate for publication and may not be cited to or by the courts of this circuit except as provided by 9th Cir. R. 36-3.

The Mortgage Network, Inc. and affiliated partnerships (collectively "Mortgage Network") appeal from judgments dismissing certain claims for failure to state a claim and granting summary judgment against them. We have jurisdiction under 28 U.S.C. §1291 and, upon a de novo review, *Stone v. Travelers Corp.*,58 F.3d 434, 436-37 (9th Cir. 1995); *Jesinger v. Nevada Federal Credit Union,* 24 F.3d 1127, 1130 (9th Cir. 1994), we affirm.

The district court correctly concluded that the allegations that Freddie Mac violated appellants' Fifth Amendment rights by terminating them without due process failed to state a claim. Freedie Mac is not restricted by the Fifth Amendment Due Process Clause because it is not part of the federal government and its termination of TMNI as a "Seller/Servicer" did not constitute federal action. *See American Bankers Mortgage Corp. v. Federal Home Loan Mortgage Corp,*__F.3d__(9th Cir. 1996).

TMNI also argues that Freddie Mac's transfer of the servicing rights in the portfolio of mortgages it serviced constituted

conversion under California law. Even if we assume, without deciding, that the mortgage servicing rights at issue are the proper subject of a conversion claim, the appellants have not raised a genuine issue of material fact as to the first element of such a claim, "ownership or right to possession of the property at the time of the conversion", *Baldwin v. Marina City Properties, Inc.*, 145 Cal. Rptr. 406, 416 (Cal. Ct. App. 1978). The contracts governing TMNI's status as a seller/servicer provided that "[m]ortgages purchased by Freddie Mac must be serviced by a Servicer", *Guide*, §6201(a), so the appellants had no right to service any mortgage owned by Freddie Mac unless they were "Servicers". The *Guide* defines a "Seller/Servicer" as "an institution approved to sell mortgages to, and to service mortgages purchased by, Freddie Mac". *Guide*, §0230. Freddie Mac, pursuant to *Guide* §§ 0402, 0403, and 6309, terminated TMNI's eligibility. Upon termination, TMNI ceased to be a "Seller/Servicer" as defined in *Guide* §0230, and by the terms of the contract, *Guide* § 6201(a), had no right to service mortgages owned by Freddie Mac. Therefore, it had no remaining possessory interest in the servicing rights and cannot establish the first element of a conversion claim.

TMNI is not entitled to raise its unconscionability defense on appeal because it did not assert it below. *Bolker v. Commissioner*, 760 F.2d 1039, 1042 (9th Cir. 1985). TMNI asserts that it stated "[t]he elements of the defense of unconscionability" in its Complaint and its opposition to Freddie Mac's motion to dismiss. Its citations, however, are to its claims and arguments with respect to tortious breach of an implied covenant of good faith and fair dealing. While one of the elements of that claim is the unequal bargaining positions of parties to the agreement, that is only one element of the unconscionability defense, and raising that one element as part of an independent claim against Freddie Mac is insufficient to raise the defense of an unconscionable contract of adhesion to Freddie Mac's defense against Mortgage

Network's conversion claim. The District Court did not wrongly fail to reach the unconscionability issue; that issue was never properly before it.

TMNI argues that it raised genuine issues of fact on its claim against Freddie Mac for relief from forfeiture under Cal. Civ. Code §3275. However, summary judgment was proper because TMNI admitted insolvency to the district court in its opposition to Freddie Mac's motion for summary judgment, an admission TMNI has repeated before this court in its Motion to Stay Enforcement of Judgment Pending Appeal. Thus, TMNI has not demonstrated that it has made, or even that it can make, the "full compensation" to Freddie Mac that § 3275 requires as a condition to relief from forfeiture.

TMNI argues that it has a triable claim for relief from forfeiture against Tridation. We decline to consider this argument as it is new on appeal, *Bolker,* 760 F.2d at 1042, as the original claim for relief from forfeiture never mentioned Tridation. Even if the original complaint were construed so liberally as to include a claim for relief from forfeiture against Tridation, that claim would fail as a matter of law. Section 3275 addresses forfeiture resulting from failure to comply with the provisions of an "obligation". While TMNI and Tridation apparently did have a contractual relationship, the alleged forfeiture from which TMNI is seeking relief did not result from failure to comply with the provisions of that contract.

Mortgage Network argues that the district court was incorrect in finding that TMNI, Partners I, and Partners II were "identically situated" for purposes of the conversion and forfeiture claims. Even if this argument were not new on appeal, and even if Mortgage Network has correctly stated California law on partnerships, the District Court's ruling was proper. Mortgage Network's complaint alleged that Freddie Mac seized mortgage servicing portfolios from Partners and Partners II, but those partnerships had no contractual relations with Freddie Mac, and

so could not have been seller/servicers. Whatever rights Partners and Partners II had in mortgage servicing performed by TMNI for Freddie Mac, those rights could have been no greater than the mortgage servicing rights that TMNI obtained under its contracts with Freddie Mac. As a result, the district court's conclusion that the partnerships were in the same position as TMNI for purposes of the claims against Freddie Mac was, on this record, correct.

The judgment of the District Court is **AFFIRMED.**

APPENDIX B

Orders of the United States District Court for the Central District of California

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Federal Home Loan Mortgage Corporation

UNITED STATES DISTRICT COURT
CENTRAL DISTRICT OF CALIFORNIA

AMERICAN BANKERS MORTGAGE CORPORATION,

Plaintiff,

v.

FEDERAL HOME LOAN MORTGAGE CORPORATION d/b/a "FREDDIE MAC" and COUNTRYWIDE CREDIT INDUSTRIES, INC.,

Defendants.

CASE NO. 93 1168 WJR
ORDER
Date: May 3, 1993
Time: 10:00 a.m.

The Motion of Defendant Federal Home Loan Mortgage Corporation to Dismiss Plaintiff's Second and Third Claims for Relief for Failure to State a Claim upon which Relief may be Granted came on regularly for hearing at 10:00 a.m. in Courtroom 10 of the above-entitled Court, located at 312 North Spring Street, Los Angeles, California 90212, the Honorable William J. Rea presiding. Lisa M. Piehl of the Law Offices of Patrick J. Thistle, Pacific Mutual Building, 523 West Sixth Street, Suite 542, Los Angeles, California 90014 appeared on behalf of plaintiff American Bankers Mortgage Corporation, John C. Morland and Susan J. Coplin of defendant Federal Home Loan Mortgage Corporation and Richard A. Schirtzer and John P. D'Amato of Quinn Emanuel Urquhart & Oliver, 655 South Hope Street, 16th Floor, Los Angeles, California 90017 appeared on behalf of defendant Federal Home Loan Mortgage Corporation.

The Court, having considered the papers filed in connection with this motion and the arguments of counsel in support of and in opposition to this motion, hereby grants the motion for the following reasons:

The Court grants the motion to dismiss the Second Claim because in order to have a cause of action for breach of the covenant of good faith and fair dealing, there must be a "special relationship" between the parties. This relationship has only been found in insurer/insured relationships thus far and is characterized by unequal bargaining power and a nonprofit motivation, *i.e.*, to secure peace of mind, etc. See *Wallis v. Superior Court,* 160 Cal. App. 3d 1109, 1118 (1984). This type of relationship does not exist between these parties. Plaintiff entered into this contract as a sophisticated financial institution and for a profit.

The Court grants the motion to dismiss the Third Claim because defendant is a private entity neither performing a government function nor controlled by the government. *See San*

Francisco Arts & Athletic, Inc. v. United States Olympic Comm., 483 U.S. 522, 542 (1987). FIRREA was enacted in 1989 to privatize Freddie Mac; it is completely privately owned now.

ORDER

IT IS HEREBY ORDERED that the Second and Third Claims for Relief of plaintiff American Bankers Mortgage Corporation be dismissed with prejudice.

DATED: May 11, 1993

WILLIAM J. REA
The Honorable William J. Rea

Case No. SACU 93-303 LHM Date 5/10/93
ID Mortgage Network v. FHLMC

DOCKET ENTRY
I HEREBY CERTIFY THAT THIS DOCUMENT WAS SERVED BY FAX DELIVERY ON PLAINTIFF/DEFENDANT (OR PARTIES) AT THEIR RESPECTIVE MOST RECENT FAX NUMBER OF RECORD IN THIS ACTION ON THIS DATE.
Date 5/11/93
Deputy Clerk

PRESENT:

Hon. Linda R. McLaughlin, Judge

Sheryl Ritchey	None Present
Deputy Clerk	Court Reporter

ATTORNEYS PRESENT FOR PLAINTIFFS:
None Present
ATTORNEYS PRESENT FOR DEFENDANTS:
None Present

PROCEEDINGS: Defendant's Motion to Dismiss Second and Third Claims

IN CHAMBERS:The Court, on its own motion, hereby VACATES the Defendant (s) hearing on 5/12/93. F.R.Civ.P. 78; Local Rule 7.11. Based on the papers submitted by the parties and applicable law, the Court now rules as follows:

(1) *Second Claim (Tortious Breach Covenant of Good Faith and Fair Dealing)*: Motion to Dismiss granted without leave to amend.

Plaintiff seeks tort damages for alleged contractual breach. California substantive law governs. In ruling on Rule 12(b) (6) motion, the Court accepts all factual allegations as true together with all reasonable inferences to be drawn threfrom, and in the light most favorable to Plaintiff. However, even applying this standard and *assuming* elements of the special relationship test in *Wallis v. Superior Court,* 160 C.A.3d 1109, may still be viable, Plaintiff has failed in its very lengthy Complaint to plead facts where the necessary near-fiduciary relationship can be found.

Foley v. Interactive Data, 47 C.3d 654, distinguished the employer-employee relationship from that of insurer-insured; but did not eliminate tort damages in all cases arising in contract. *Wallis*, which pre-dated *Foley*, was not discussed in *Foley*. Therefore, the analysis of the elements of the special relationship test in *Wallis* may still be viable. However, the subsequent cases have limited the circumstances for application of the special relationship test to those where a near-fiduciary relationship would be found. *Mitsui Manufacturers Bank v. Superior Court*, 212 C.A.3d 725; *Trustees of Capital etc v. Shearson Lehman*, 221 C.A.3d 617.

(2) *Third Claim for Relief based upon Fifth Amendment;* Motion to Dismiss granted without leave to amend.

The Court adopts Defendant's Points & Authorities in moving and reply papers to support ruling.

(3) Defendant's Answer shall be filed and served pursuant to F.R.Civ.P. 12(a).